Economic Leviathans

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Students of world economic affairs in the inter-war period were impressed by the extent to which the world scene was dominated by the economic policies (or impolicies) of two great economic leviathans: the U.S.A., and the United Kingdom as the centre of the sterling area. The smaller national economies, including our own, were, in relation to these, very much in the position of a dinghy in comparison with an Atlantic liner. We got the wash from their, sometimes, erratic movements, but there was very little we could do to save ourselves. If a smaller nation committed economic follies it was the chief sufferer itself, and the international economy was little affected by the actions of any one small national economy, though doubtless, in the aggregate, the actions of many small national economies were not without an important cumulative effect. In those days what really mattered on the world scale was the doings of the U.S.A. and the British Commonwealth of Nations. There was of course a third leviathan, away in Eastern Europe, but its economic relations with the rest of the world were compatible with the continued functioning of an international economy, or at all events they were not important enough to be able to upset it.

In those far-off days the British and the American leviathans were almost equally important. If anything, the British leviathan was the more important from a world point of view.

In 1929, the National Income of the U.S.A. was 83 billion dollars. That of the United Kingdom was 4,384 million pounds (Colin Clark, *National Income and Outlay,* p. 88). With about three times the population, the U.S.A. had rather more than four times the National Income of the United Kingdom.

The National Income of the U.S.A. is now about eight times that of the United Kingdom. This conclusion is arrived at if we compare the Gross National Product of the U.S.A. for 1949, i.e., $255·6 billion, with that of the U.K. for the same year, i.e, £11,426 million, and translate pounds into dollars at the official rate of $2·80.

The post-war world has witnessed an enormous relative increase in the economic importance of the American leviathan, a corresponding relative decline in that of the British, while the third leviathan has extended its influence over east central Europe, and now dominates most of the Continent of Asia. The economic fate of the free world now depends on the wisdom with which the mighty American leviathan exercises its enormous economic power, and the future of world peace depends on the relations, not now very cordial, between the only two leviathans that really matter in the post-war world.

There is an enormous disequilibrium between the wealth of the U.S.A. and the comparative poverty of Western European countries, and a still wider gulf yawns between that enormous wealth

and the semi-starvation conditions that prevail among about 1,000 million people who exist in the undeveloped areas of the world, Communist and non-Communist alike. A Third World War would produce a kind of equilibrium—the equilibrium of death. A large-scale world depression would lessen the wealth of the U.S.A., without increasing the wealth of the rest of the world, and would not be conducive to the maintenance of world peace. The object of this paper is to set out the various economic conditions which must be satisfied if the world as a whole is to be guided into an era of prolonged peace, and the free world is to have such relations with the dollar area as will restore equilibrium and preserve the substance of national independence for the smaller nations, including the members of the British Commonwealth.

In the inter-war period the enormous advantage of a freely functioning international economy, after being apparently recovered in the middle 1920's, was lost in the early 1930's, and has never since been regained. Such an economy implies multilateral international trade, convertibility at fixed rates of major international currencies, absence of restriction in foreign exchange transactions, non-existence of import and export quotas, and a level of tariffs which is compatible with the transfer of payments from debtor to creditor countries. The experience of the inter-war period provides many salutary lessons for those who now control the destinies of the free world.

The United Kingdom restored the Gold Standard in 1925 at a value of sterling which proved excessive in the light of subsequent events. The fall of sterling from gold in 1931 involved the disruption of the international economy. If that disaster could have been avoided by restoring the pound to, say, a \$4·50 valuation in 1925 instead of \$4·86, Lord Cunliffe and his associates have a lot to answer for. The monetary policy of the British leviathan certainly had some responsibility for the break-up of the international economy in the inter-war period.

However, the American leviathan also made important contributions in the same cause. It was a commonplace of economic thought in those days that the U.S.A. refused to adjust her economy to receive an import surplus while insisting on the payment of inter-allied debts, and that the international economy only functioned as well as it did in the 1920's because U.S.A. nationals were making considerable, but unregulated, financial investments in restoring the shattered economies of Central Europe. (*United States in the World Economy,* p. 4.) When these loans suddenly dried up in 1929, the debtor countries were placed in an impossible position, and the international economy in its monetary aspect was doomed.

A reduction of the American tariff in 1930 would have been helpful in this crisis, but instead the Hawley-Smoot tariff was enacted, which raised import duties to an average of about 20% above the level of the Fordney-McCumber tariff of 1922. An American writer describes the 1930 tariff as having been passed at the behest of "a narrow-minded and ignorant lobby." (J. P. Day, *World Economic History,* p. 87.)

The disruption of the International Economy was thus the result of the policies or impolicies of the two great economic leviathans

The outward and visible sign of this disruption was the emergence of the sterling area, the dollar area, and the gold bloc currency area which soon disintegrated. Till 1933 the dollar remained uncomfortably as part of the gold bloc currency area, but went its own fluctuating way in April, 1933, and was finally devalued to 60% of its former value, and put back on a gold basis in January, 1934. The significant thing, from our point of view, is that the sterling area was able to go its own way, regardless of the dollar, and stage a substantial degree of economic recovery, under British pressure and leadership, partly at the expense of the U.S.A.

Great Britain was still a substantial creditor nation on international account. The sterling area was the most important section of the world market. Sterling prices retained a remarkable degree of stability, and their very stability, in conjunction with a declining gold value of sterling, forced down the prices current in France and other gold-standard countries, and created a situation in which it was to the interest of an increasing number of countries to jump on the sterling band-waggon. The U.S.A. official publication referred to above (*The United States in the World Economy*) makes it quite clear that in the 1930's U.S.A. did not share equally in the revival of world trade as a whole, and in fact her economy remained in the doldrums until the stimulus of the Second World War was applied.

In the present post-war era it is no longer possible for the sterling area to stage a permanent recovery without regard to the policies pursued in the dollar area. The dominant fact is that the United Kingdom, which before the Second World War was a creditor nation to the extent of some £4,000 millions, is now in effect a debtor nation. Her surviving external assets are more than offset by the sterling balances she now owes to the rest of the sterling area and to other countries.

A brief outline of the financial relations between the United Kingdom and the United States will illustrate this. Under the " Cash and Carry " conditions which governed U.S.A. trade with the belligerents at the outbreak of the Second World War, the United Kingdom had practically exhausted her gold reserve in paying for necessary imports from U.S.A., when President Roosevelt instituted the Lend-Lease device, which enabled the flow of supplies to continue, and shelved the question of ultimate payment. When the Pearl Harbour episode brought the U.S.A. into the War, the system was continued on an even more liberal scale. It was taken for granted in Britain that even after V.E. Day Lend-Lease supplies would be continued, though on a diminishing scale, thus giving Britain and her European allies time to adjust their distorted economies to the requirements of peace. Perhaps it was only a coincidence that the advent of a Labour Government in 1945 was followed by a sudden decision by President Truman to cut off Lend-Lease supplies. This was a serious economic shock, for Britain was thereby faced with the alternative of a drastic reduction of the standard of living for her war-weary people, or borrowing a matter of £1,000 millions from the U.S.A. on terms sufficiently onerous—in spite of the persuasiveness of the late Lord Keynes.

The United Kingdom had to agree to make all current receipts

of sterling payments, after July, 1947, freely convertible into dollars. The controls were taken off American prices, which surged upwards, and the money borrowed bought only a fraction of the goods anticipated, and was exhausted in little more than a year. Sterling was indeed made convertible in July, 1947, but the British economy could not stand the strain. Within six weeks gold and dollar reserves were approaching exhaustion, and Britain had to resume a rigid control of the sterling exchange and unilaterally repudiate that part of her obligation.

The economy of Britain was severely shaken by this episode, and about the same time economic chaos was threatening in France and Italy, thus creating a situation favourable for Communist expansion. To relieve the situation a large-scale transfusion of dollars to anæmic European economies was proposed by General Marshall, and eagerly accepted by the various Western European Governments, under the leadership of Ernest Bevin. The Governments of Poland and Czechoslovakia were also inclined to accept in the first instance, but under pressure from Russia decided to remain outside.

The Marshall Plan pumped billions of dollars into Western Europe, and promoted a substantial degree of economic recovery, without however providing any permanent solution for the fundamental problem of the U.S.A. export surplus *vis-à-vis* the chronic European deficit in relation to the dollar area. In 1947 the European deficit was \$7·6 billion, and in 1948 \$5·6, an improvement of \$2 billion. The *Economic Survey of Europe in 1948* (p. 212) calculated that European exports would need to be increased by from 55 to 60% to cover the cost of the imports of 1948 without external aid. But such an increase was unlikely to take place unless there was a reorientation of U.S.A. economic policy, as well as an increase in European productive capacity.

The year 1949 brought no such reorientation, but brought instead an unexpected recession of trade in the U.S.A., fortunately of short duration and of modest dimensions. But the importance of the American leviathan is such that even the slightest economic change in that country has the most serious repercussions abroad. When U.S.A. enjoys full employment imports, especially of raw materials, are well maintained in volume and value. The surplus dollars acquired by the sale of Malayan rubber and tin, and Australian wool, are normally spent in paying for a surplus of British imports to these sterling area countries, and this in turn enables the British economy to earn at least some of the dollars needed for financing its considerable surplus of dollar imports.

This point is well brought out in a public lecture by Professor C. F. Carter to an audience in Queen's University, Belfast, on 3rd November, 1952. "Minor changes in American business conditions tend to have a violent effect on her trade, and to be a grave disturbance to international trade as a whole. The U.S. is the greatest trading nation in the world. Thus the mild decline in 1949, with a fall of only 1% in the U.S. national product, knocked more than 20% off her imports from the U.K. The depression of 1938, with a fall of 6% in national product, and of 30% in factory production, was associated with a fall in American imports

from the U.K. of more than 40%, and in imports from the rest of the sterling area of more than 50%. Even this seems mild beside the 81% fall in imports from the overseas sterling area in the Great Depression of 1932."

The brief recession of 1949, besides reducing the volume and value of sterling area imports to U.S.A. (thus lessening the inflow of dollars to the dollar pool), was associated with a downward movement in the general level of dollar prices. On the other hand, British export prices, with an index of 208 (1938=100) in the third quarter of 1949, were higher than in 1948 when the index was 203. (*Economic Survey of Europe in 1949,* p. 151.)

British exports were now being priced out of dollar markets, and sterling as well as other non-dollar currencies were now obviously overvalued at current exchange rates. The effect on the dollar pool of the sterling area was serious. " At the end of June, 1949, gold and dollar reserves were down to £407 millions. The deterioration was partly due to reduced U.K. exports to the dollar area, and partly to the smaller quantities and lower prices of commodity exports bought by dollar countries from the sterling area." (*London and Cambridge Economic Service,* August, 1949.)

The authorities of the International Monetary Fund compelled Sir Stafford Cripps to agree to a drastic devaluation of sterling in September, 1949.

In the opinion of the *Economic Survey of Europe in 1949,* p. 161, the devaluation made little or no contribution to the fundamental problem of Europe's chronic dollar deficit *alias* U.S.A.'s chronic export surplus. The principal beneficiaries were overseas soft currency countries exporting primary products. Their gain was reflected in a worsening of the terms of trade as between the U.K. and the rest of the world.

This has been the perennial dilemma of the British economy since the Second World War. When raw material prices rise the dollar pool fills up and the sterling exchange is strong, but British terms of trade are worsened, and sterling balances owed by Britain to the rest of the sterling area are apt to increase. When raw material prices fall the dollar pool of the sterling area empties and the sterling exchange is weak.

If the Korean episode of June, 1950, had been foreseen in September, 1949, it is possible that there need have been no devaluation at all.

The outbreak of the Korean War was followed by large-scale buying of rubber, wool, tin, and other raw materials as "strategic materials" for stock-piling by the U.S.A. Government. There was also considerable buying of consumer goods on private account in anticipation of a war-time scarcity which, however, did not eventuate. Australian wool-growers made fantastic gains, and the dollar pool filled up most comfortably during the latter part of 1950. When prices had risen to record levels, the American Government suddenly ceased to stockpile, and prices fell rapidly to less than their former level. This caused a new crisis in the sterling area balance of payments, which was very acute in the latter part of 1951.

According to the *Economic Survey of Europe in 1950* (p. 121), the buying spree of the latter half of 1950 " converted a net drain of $167 millions in gold and dollar reserves in 1949 into a net increase of $1,612 million in 1950—that is, a total shift of $1·8 billion."

From the point of view of the relations of the U.K. with the rest of the sterling area the situation was not so good. The chief dollar earners in that hectic year were the rest of the sterling area—conveniently referred to as R.S.A. But the latter also increased considerably the value of their exports to the U.K., receiving in return additional sterling balances which the British economy proved to be in no condition to liquidate.

According to the *Economic Survey of Europe in 1950* (p. 123) " The remainder of the increase in reserves was attributable to the increased earnings of the overseas sterling countries, against which the United Kingdom accumulated heavy new liabilities in the form of sterling balances. The total of these balances held by the rest of the sterling area rose, by the end of 1950, to a level higher than at any time since the end of the War."

At the end of the War the net banking liabilities of the U.K. to the R.S.A. were £2,674 million (Paul Bareau, *The Sterling Area,* p. 11). According to the *Economic Bulletin for Europe, Second Quarter, 1952,* p. 14, sterling balances owed to R.S.A. were on 31st December, 1949, £2,353 millions, on 30th June, 1951 £3,100 millions, and on 30th June, 1952, £2,555 millions. The aggregate diminished between 1951 and 1952 because the free Dominions vastly increased their surplus of imports from the United Kingdom. However, the dependent overseas territories had to content themselves with a considerable addition to their sterling balances. In fact the sterling owed to the " Colonial Empire ", which was £583 millions on 31st December, 1949, rose to £1,042 millions on 30th June, 1952. In view of the much publicised Colombo Plan, there is a certain irony in the fact that the indigent citizens of the Colonial Empire are now financing Britain's Welfare State and the Rearmament Drive to the tune of £1,042 millions!

Thus the economy of other countries is upset when 150 million Americans go on a buying spree. It is equally upset when they go on a saving spree, as they unexpectedly did after the first quarter of 1951. According to the *Economic Survey of Europe in 1951,* p. 61, personal savings in the U.S.A. rose from $8·5 billions in the first quarter of 1951 to $21·2 billions in the second and third quarter and, incidentally, the volume of U.S. imports dropped by 10% in those quarters of 1951.

On p. 83 of the same publication it is suggested that there may be a revival of American demand for sterling area raw materials, but the warning is added that the free Dominions are now disposed to use all, and more than all, the dollars they earn in the purchase of American imports. " The difficulty of holding down dollar imports is enhanced by the limited availability of metal and engineering exports from the U.K. This dilemma again emphasises that the present payments crisis of the U.K. stems in large part from the conflict between a necessarily moderate rate of increase in production and a relatively ambitious armaments programme."

Professor Carter, in the lecture referred to above, has suggested that the Commonwealth is not in a strong position to improve its dollar earnings for the sterling pool in future, and that individual members of the sterling area might, with advantage, get more control over, and responsibility for, their own dollar reserves, " so that the connection between bad policies and bankruptcy would be perceived more quickly." Countries like Australia and South Africa are more and more attracted into the dollar orbit, and more and more disposed to look to the U.S. capital market as the only possible source of long-term foreign capital. Professor Carter's tentative suggestion about dollar reserves would amount to a voluntary dissolution of the sterling area banking system, and a voluntary abdication of British leadership in it. It might be well to anticipate such a result as an act of conscious policy rather than allow it to happen, because it could not be prevented. The present position of sterling *vis-à-vis* the dollar recalls the Arabian Nights tale of the ship that came too close to the magnetic mountain, with the results that its rivets were withdrawn and it foundered. Let us hope that there are other and more constructive uses for the magnetism of the American dollar.

Apart from the short-term fluctuations which threaten the stability of the sterling exchange, there are other and more permanent factors now in operation which imply a more serious threat. A small island with a vast population and few domestic raw materials except coal, Britain literally must " export or expire." The loss of external investments increased the paramount necessity of the export drive and there was in fact a most creditable and gratifying increase in the volume and value of British exports from 1944 to 1952. In the first quarter of the latter year the volume was as much as 88% in excess of the 1938 level. In the third quarter it had fallen to 57% in excess, the same level as in 1949. (*London and Cambridge Bulletin*, December, 1952, p. xvi.) It must be remembered that besides paying for necessary current imports of food and raw materials, long-term solvency requires the capacity to provide substantial amounts of " unrequited exports " in liquidation of sterling balances and other foreign debt. Otherwise external creditor countries will be disposed to discount the value of their sterling claims and look elsewhere for necessary imports. Such a situation, if allowed to develop, would be equivalent to national bankruptcy on international account for the U.K., and in human terms would mean large-scale unemployment, a greatly reduced standard of living for all, and perhaps actual starvation for thousands of residents in these overcrowded islands.

In recent years there has been a rapid growth in the exports of Western Germany, and increasing competition from Japanese exports to markets in South-Eastern Asia and elsewhere. According to the *Economic Survey of Europe in 1951*, p. 73, British exports to Western Europe were 1 per cent. less in volume in 1951 than in 1950. The volume of Western Germany's exports to the rest of Western Europe was 41% more in 1951 than in 1950. Britain increased the volume of her exports to overseas markets by 8% in 1951 as compared with 1950. Western Germany increased hers by 105%.

Prior to 1939 44% of Japanese exports went to China and Korea. The policy of the predominant partner now forbids Japanese exports to Red China, and in the first half of 1951 only 14% of Japanese exports found a market in China and Korea. Her exports to South-East Asia increased from 17% before 1939 to 35% in the first half of 1951. Japanese industrial production and exports are still far from their pre-war capacity. When they have reached and passed that level, the outlook for Lancashire in far-eastern and overseas markets is distinctly grim.

As the *Economic Survey of Europe in 1951,* p. 101, puts it, " the problems involved in the reappearance of Japan on the world market are rendered more difficult by the political conflict in the Far East." In fact there is a " bamboo curtain " as well as an Iron Curtain, and the commercial restrictions incidental to both intensify the long-term problem of preserving Britain's international solvency and the stability of sterling.

A fundamental solution to the dollar shortage problem may be sought in two main directions, either alternatively or in combination; for they are not incompatible, though both *are* incompatible with the policies dictated by the exigencies of the Cold War.

One is a revival and considerable development of commercial intercourse between Eastern and Western European countries, in fact a tearing down of the Iron Curtain in its economic aspect.

The other is implied in the principles recommended in *The United States in the World Economy* which, when it appeared, was looked on hopefully as an official blue print for post-war American foreign Economic policy. The authors of the annual *Economic Survey of Europe* subscribe to similar principles, but have occasion to point out that post-war U.S.A. practice was by no means compatible with the official blue print of 1943.

An article by D. B. Halpern (London) appeared in the *Economic Journal* of March, 1951, under the title " European East-West Trade and the United Kingdom's Food Supply." It appears from this article that in 1948 East-West European trade was only 42% of its pre-1939 volume. Moreover, trade in the inter-war period was much below the level to which it had developed prior to 1914. Hence, he argues, the immediate pre-1939 position is no index of what is desirable or economically possible.

The reduction of this trade in the present post-war period is due, among other causes, to the restriction on the export of " strategic " manufactures and scarce raw materials now made more stringent under the terms of the " Battle Act."

Mr. Halpern further points out that the commodity composition of Western Europe's imports from Eastern Europe in 1938 was very much the same as that of Western Europe's imports from U.S.A. Between 1938 and 1947 imports from Eastern Europe declined and imports from U.S.A. increased. Of the increased imports from U.S.A. he suggests, $1,400 million paid for cereals and $900 million for textiles could have been eliminated by a revival of East-West trade.

Western Europe certainly needs to import food and raw materials, but Eastern Europe is no longer content with the same pattern of imports as before. They are intent on creating a more

balanced economy, and "They now want essential goods: raw materials and capital goods to help their industrial development." Unfortunately these belong to the category of "strategic goods."

If only economic considerations were in question it would be easier for Eastern Europe to develop industrial capacity by a temporary emphasis on the production and export of food and raw materials. This is the classical method by which Sweden, and even the U.S.A., have risen to industrial greatness. If reciprocal trade on these lines is restricted, the capacity to produce and export surplus food and raw materials may disappear from Eastern Europe, while the policy of intensive industrialisation will be pursued in any case. Thus the two areas would harden into permanent and hostile isolation, and there would remain no reciprocal economic basis of mutual dependence on which a policy of "live and let live" might conceivably some day be built. For Western Europe such a development would increase its dependence on overseas and dollar area food and raw materials, and aggravate the problem of the chronic dollar shortage.

However, Mr. Halpern thinks that in return for a reasonable supply of capital goods it would be worth the while of Eastern Europe to export an increasing surplus of food products. The "satellite" countries might indeed have little food to spare as population increased, but (p. 114 *loc. cit.*) "As far as the Soviet Union is concerned, there is, for all practical purposes of Western Europe, neither a limit nor an end to either the volume or the variety of food supplies, provided the political (and possibly later, the financial) difficulties can be overcome."

The second main method by which the fundamental problem of the American export surplus *vis-à-vis* the European dollar shortage could and should be attacked is indicated in the official blue print of 1943. *The United States in the World Economy.* In this valuable publication the mistakes of inter-war policies (or impolicies) are frankly recognised, and the desirable lines of a future post-war policy clearly indicated, as is evident from the following quotations: "What is emphatically not possible is to have it both ways—a large volume of dollar receipts against a small volume of dollar payments. Yet the United States foreign economic policy in the past has been largely predicated upon this manifest impossibility, most notably when the tariff on imports was sharply increased on two occasions in the face of continued efforts to collect war debts and promote exports." (p. 24.) On p. 19 it is pointed out that "the future interests of the United States . . . are therefore to maximize its international transactions and, to this end, to make available a larger and more stable supply of dollars. There are two principal ways by which this result may be attained, and these are not mutually exclusive, but rather are naturally complementary. One way is by a renewed outflow of American capital, and the other by a positive measure to permit a larger volume of imports."

The operative phrase is "more stable". With regard to the irregular and unpredictable flow of American capital abroad in the inter-war period the blue print states (p. 4): "Foreign countries needed and demanded American goods and American capital, and

it was natural that the United States should have supplied both. The mistakes were rather in the particular behaviour of our lending operations—not so much in our investment policy as in the lack of one.''

That the actual assumptions of American post-war foreign economic policy up to 1949 were in flat contradiction with the recommendations of the official American blue print of 1943 is evident from the preface contributed by Gunnar Myrdal (the distinguished Swedish economist) to the *Economic Survey of Europe in 1949.* He points out on p. vi that " United States foreign economic policy in recent years appears to have been based on the assumption that the world supply of dollars would be adequate to permit the continuation of a relatively high level of American exports and to overcome the present dollar shortage experienced throughout most of the world. This is indicated, for instance, by its efforts to maintain foreign markets for American agricultural products . . . and by the importance attached by the United States . . . during and since the War to the restoration of multilateral trade and currency convertibility. The analysis in this Survey leads to the conclusion, however, that the assumption underlying these policies will have to be revised if it is, in fact, impossible to lower United States tariffs sufficiently to permit a large increase of imports—and if neither public nor private American capital is likely to be invested abroad on a scale sufficient to compensate for the decline in United States Government grants now provided to many foreign countries."

On p. 181 of the 1949 Survey it is pointed out that with the end of Marshall Aid in sight Europe would have to do with \$2 billion less American goods annually than it had in 1948, but (p. 193) " could probably make the necessary adaptations to this further reduction in imports of dollar goods given appropriate policies for the development of substitute supplies from European and other non-dollar sources.''

That the authors of the 1949 Survey had in mind chiefly the economic desirability of developing East-West European trade is clear from a statement on p. 94 : " The major reason for the stalemate in East-West trade is clearly the political cleavage between East and West. As long as mutual distrust on the present scale prevails, there can be little hope that the potential contribution of trade between the naturally complementary economies of Eastern and Western Europe can be realised. Export licensing controls applied by the United States and Western European countries continue to curtail exports to Eastern Europe.'' The Survey goes on to point out that the economic consequences for Western Europe are that this method of circumventing the dollar shortage problem is effectively blocked : " For Western Europe the question is primarily that of the balance of payments or, more specifically, the need to find markets which can both absorb exports of manufactures and supply foodstuffs and raw materials. The failure of East-West trade to recover intensifies this problem."

Apart from the development of East-West trade which, however desirable economically, is not practical politics in the present international atmosphere, there is the other approach to a fundamental

solution of the dollar shortage problem—the approach outlined in the blue print of 1943. This presents serious difficulties of an economic and psychological as well as of a political character. The U.S. economy is exceptionally self-sufficient, and has become more so as a result of the second World War. Total production in U.S.A. was two-thirds larger in 1948 than in 1929, but the total amount of imports was only 5% greater in real terms. The import of manufactured and semi-manufactured goods from Europe was $1,750 million less in 1948 than might have been expected on the basis of pre-war experience. (*Economic Survey of Europe in 1948*, p. 218.) The ratio of imports to national income, which before 1914 was about 5%, was in 1939 just over 3%. (*United States in the World Economy,* p. 38.) American tariff and customs procedure still effectively excludes many European commodities which might otherwise successfully compete in U.S.A. markets. For reasons of domestic policy U.S.A. is unable to contemplate a serious reduction of the American export surplus. For similar reasons there can be no serious increase of imports of manufactured goods to U.S.A. The dollar shortage *alias* the American export surplus problem could in theory be solved by a reduction of exports and by an increase of imports. " A similar dilemma faced the U.S. after the first World War when it requested European countries to repay their war debts but was unwilling to admit imports on a sufficient scale to make their payment possible. The situation following the second World War has become still more distorted, since it would now be difficult for the United States to absorb sufficient imports to pay for current exports, let alone for the repayment of debt." (*Economic Survey of Europe in 1948*, p. 220.)

Apparently not much is to be hoped from a possible relaxation of U.S.A. import tariffs. There remains the possibility of remedying the world's dollar shortage by a substantial and reliable flow of American capital into long-term foreign investment. The *Economic Survey of Europe in 1948* (p. 222) outlines a plan (in the spirit of the 1943 blue print) which would solve the American export surplus problem and enable European countries to recover economic independence and earn an adequate supply of dollars without owing them. America should plan ahead its long-term lending to the rest of the world (especially to the undeveloped areas), so as to generate a steady and predictable long-term flow of dollars. These dollars would thus be available to the borrowing countries for " off-shore " purchases of goods manufactured in Western European countries, which, in turn, would use them to pay for their current surplus of imports from U.S.A. The economies of these European countries, already highly industrialised, could easily be adjusted to the export of the capital equipment so much required by the undeveloped areas of the world. They would have every inducement to go after and earn those dollars, and in that way restore an economic equilibrium in which multilateral trade and convertible currencies could easily be established and maintained. But " The whole purpose of rectifying the world dollar shortage would be thwarted if the funds supplied were directly tied to expenditure on U.S. goods; and the financing should be of specific projects designed to make the maximum contribution

to a rapid increase in world productive capacity." (*Economic Survey of Europe in 1948*, p. 224.)

During the nineteenth century Britain invested thousands of millions sterling in developing the economies of overseas countries, Empire and non-Empire alike, including the economy of U.S.A. After her losses in two world wars she is no longer in a position to make any such substantial foreign investments, and in fact is hard put to it to repay her external financial obligations. Britain, of course, had an overseas Empire to develop, and its development was looked on as a moral obligation as well as a financial advantage to all concerned. U.S.A. has no overseas Empire of similar dimensions to develop, and it is psychologically as well as politically more difficult for her citizens to realise the necessity of making substantial foreign investments however necessary such investments may be, even from a U.S. point of view, in the light of an objective economic analysis.

American capital flows freely into Canada, which needs it, probably, less than any other country in the world. It flows less easily into the backward economies of South America or Africa, and its flow into Europe is accompanied by onerous political conditions.

America's expenditure on rearmament is now of the order of $50 billion a year. Its motive is a genuine fear of anticipated Communist aggression, but it may also be due, to some extent, to an instinctive reaction to the danger of a new economic depression. The true economic solution to the problem of the American export surplus is not, apparently, practical politics. If the Americans had an overseas Empire of their own to develop, they might be disposed to consider the true economic solution more favourably. Perhaps they are, in fact, in process of becoming the inheritors of the remnants of the British, French and other Colonial Empires, while their financial relations with the Dominions of the British Commonwealth are becoming closer and closer. The Americans have a characteristic national objection to being had for a "sucker". They find it psychologically easier to invest $1 billion in rearmament than $100 million in a country which could not be trusted to repay the debt.

The burden of rearmament imposed on the N.A.T.O. countries is well within the economic capacity of U.S.A., but the economies of her allies, impoverished by two World Wars, are creaking and groaning under the strain. The Americans find it difficult to understand this, for within living memory, those same two World Wars have brought their country unexampled prosperity and a substantial increase in the standard of civilian consumption.

If the analysis contained in this paper is sound, the relations between the American and the British leviathan are now such that a mere continuance of the "Cold War" must reduce Britain to international insolvency and bring about the dissolution of the sterling area. If in that case the U.S.A. becomes her successor in title, we may hope that it will then become possible to implement a foreign investment policy which will solve for ever the problem of the dollar shortage.

There is always, of course, the unknown factor of what the third leviathan may do about it all, and the possibility of a third

World War of the highest possible temperature. Owing to the intractable nature of the economic factor, the growing military strength of the N.A.T.O. powers has lagged a year, or perhaps two years, behind schedule. It is, perhaps, a hopeful augury for future co-operation between the two major leviathans that the opposing team, so to speak, has agreed to postpone the match to a more convenient season. It was also most considerate of the Eastern leviathan that it has not cancelled the fixture outright. Any sudden outbreak of real peace would inflict a most serious shock on capitalist economies, geared to rearmament in the highest possible degree, and the consequences might well be such as to afford satisfaction only to the enemies of the free capitalist democracies.

As President Truman has recently pointed out, the methods of modern warfare involve the extermination of millions of civilians, but the values associated with our Christian civilisation are so precious that we must not hesitate to inflict millions of civilian casualties on enemy countries that do not accept those values, if their rulers are so foolish as to stage a real " show down " with us.

That, perhaps, raises a moral question, but moral considerations are notoriously irrelevant in a work of economic and statistical analysis.

DISCUSSION.

Mr. T. K. Whitaker, who proposed the vote of thanks, congratulated Professor Johnston on a miracle of compression, the presentation in 12 pages of a lucid and stimulating survey of broad economic trends over the last two decades. The most interesting part of the paper was the final portion in which the dollar problem was discussed. At a few earlier points, condensation and emphasis had led to some questionable statements. For instance, the suggestion that Sir Stafford Cripps was " compelled by the authorities of the International Monetary Fund to agree to a drastic devaluation of sterling " could scarcely be accepted. Devaluation was brought about by more fundamental and powerful forces; in addition to the income and price fall in the U.S. and the drop in U.K. exports there was the persistence of inflation in Britain which upset the balance of payments and afforded reason for speculation against the maintenance of the exchange value of sterling. The uncertainty itself caused outward payments to be accelerated and inward payments to be delayed and thus accentuated the drain on the inadequate gold and dollar reserves.

Professor Johnston also seemed too daring in asserting that if the Korean War had been foreseen there need have been no devaluation at all. The most one could reasonably say was that it might have been temporarily averted. The post-Korean increase of the sterling area's dollar earnings was short-lived. Internal inflation persisted and, despite the immediate effect of devaluation in restoring competitiveness, British exports in 1952 were static. Imports, on the other hand, were severely restricted by a whole

panoply of controls. If these controls were abandoned, could anyone predict with assurance that the £ would not fall below even its present devalued rate of $2·80?

Throughout the paper there seemed to be a tendency to put all the blame for economic disorder on the " Leviathans " and particularly on the United States. Europe could not be held entirely blameless. Nor was rearmament the sole cause of Europe's troubles. Rearmament was relatively recent and no explanation was complete without reference to the persistence of inflation and to the way in which welfare programmes in the U.K. and elsewhere had outstripped increases in production.

Mr. Whitaker said that Professor Johnston's reference to the possible liquidation of the sterling area appeared to be based on the belief that various important members could now survive on their own dollar earnings. It was, however, only in the 1950-51 Korean phase that the Independent Sterling Area became dollar solvent. It incurred dollar deficits throughout the period 1946 to 1949 and again since mid-1951 Australia, India, Pakistan, Ceylon, Iraq and South Africa were in deficit. Ireland was always in the red. Only New Zealand, Southern Rhodesia and Libya had dollar surpluses in recent times and they were very small. The position still was that all the members remained interested in having access, with Britain, to the dollar surpluses earned consistently by the British colonies.

The dollar gap, like any other gap, could be bridged exclusively from one side or the other or by a joint effort. Professor Johnston seemed right in discounting the likelihood of an adequate and sustained increase in American imports, the level of which depended so much on the state of internal activity in the U.S. American private investment had been largely in specialised fields, such as oil wells and mining, and was also unstable in amount. American public investment through the International Bank, etc., was hampered by the lack of colonial possessions and by an excessive preoccupation with profitability; the political and social implications of the poverty of the undeveloped areas of Asia and Africa needed greater attention.

Europe had done a good deal to close the gap. Output was now 40 per cent. above pre-war, but the rise had slowed down. The dollar gap was still between $2 billion and $3 billion despite import and exchange controls which discriminated against dollar goods. Unless greater efficiency and a greater exportable surplus could be attained, further devaluations might be the only solution, but there were various reasons against their being too drastic. American help in the form of a guarantee of stability in the supply of dollars through imports and investment—not dependent on annual votes of Congress—would be a tremendous boon.

Professor G. A. Duncan.—By a " national economy " I presume one ordinarily means a segment of the economic world separated off by political and fiscal barriers; under what circumstances does the relative size of each of these artificial segments really matter? Obviously not at all in so far as a freely-functioning world market

exists. In that case, for example, the development of a cycle will be governed by what happens in industrial concentrations, and whether these concentrations are accidentally located in a large fiscal segment like the U.S.A. or a small one like Belgium is irrelevant. Surely it is only when the artificial barriers are so high and so arbitrary (and their arbitrariness is even more important than their height) that the rulers of each segment can pursue independent and irresponsible "policies" that the size of the segment becomes relevant.

It seems rather odd to me to speak of the "comparative poverty" of Western Europe. Even after the destruction of two wars and the politicians, Western Europe (excluding Spain and Southern Italy) is still enormously wealthy in comparison with three-quarters of the human population infesting the globe. It is true that the composition of that wealth has changed startlingly since 1900 (instead of food and comfort, we have television sets and public services), and that the change has made our wealth infinitely less mobilisable to meet an emergency, but the wealth is still there. In passing, "disequilibrium" seems to me to be the wrong word to apply to the comparison between the U.S.A. and Western Europe. The word always implies something unstable and dangerous, and there is nothing unstable or dangerous necessarily in the symbiosis of rich and poor communities. We have had rich and poor communities living stably together since the dawn of history, and even in the U.S.A. there is no lack of poor communities. Consider the kind of arguments that would be used now if the secession had succeeded.

I am always somewhat sceptical about the "burden of rearmament" now. In real terms, I do not see it as any heavier than was borne without being noticed in 1909-14. The change seems to me to be far more psychological than real (Cf. Athens in the fourth century B.C.), and, so far as it is real, to be connected with the immobilisation mentioned above.

Mr. Bourke.—I am very glad to join in expressing the appreciation of the Society to our President for the paper which he has read. It is obvious that he has put a great deal of work into it, but I do not agree with the atmosphere of pessimism which seems to pervade it.

The dissolution of the Sterling Area has been prophesied more than once but, notwithstanding its vicissitudes, it still survives. Despite its many drawbacks, sterling is still used extensively as a world currency. The trade between the Sterling Area and the rest of the world amounts to about £10 thousand million a year, and this does not include the trade which takes place between the members of the Sterling Area themselves. No adequate substitute for sterling as a world currency has been found nor does one appear likely to emerge.

I am in profound disagreement with the suggestion that peace would inflict a most serious shock on capitalist economies. These economies have demonstrated their ability to absorb without undue strain the switch-over from war conditions to peace, and

the transition from the rearmament phase should be very much easier.

I do not think there is any doubt that the growth of the United States to the status of a great industrial power has been a good thing. The same is true of the similar growth of Great Britain in the 19th century. The world is so economically interdependent that if a country—and especially a great country—is prosperous, a good deal of that prosperity will overflow to other countries. This does not mean that if there is economic recession in the United States other countries will not be affected. They will, but I suggest that notwithstanding such recession they will still enjoy a higher standard of living than would be the case if the United States had not had the great expansion which the last 100 years have witnessed.

As regards the dollar gap, it seems to me that each country must make some contribution by putting its own house in order, one of the principal difficulties being deficits in the Balance of Payments brought about by inflationary policies. Professor Johnston has referred to the thousands of millions of sterling utilised as a result of British industrial expansion in the 19th century in the development of overseas countries. It seems to me to be very evident that the United States economy will react in the same way. There are more difficulties now than there were in the 19th century. In many countries there are Exchange Controls, Control of Foreign Investment and other factors which discourage foreign investment, but these difficulties should not be insuperable. This is one side of the gap. The other side of the gap is the greater absorption by the United States of imports, and here also there are possibilities. There are great potential markets for imports in the U.S.A., not perhaps for mass-production goods but for products which rely upon high quality, craftsmanship, etc. The earnings from the tourist industry alone are capable of great expansion in terms of dollars so far as European countries are concerned. In the United States there is a great population with a surplus spending power hungry for European travel and all that an age-old Europe has to offer.

I do not think that the dollar gap can be *easily* bridged but I am optimistic that it will be bridged. The pound in 1952 would buy about one-third as much as it did in 1913 while the dollar would buy in consumers' goods about 38% as much as in 1913. The shrinkage in the purchasing power of the respective currencies between 1939 and 1951, as measured by the cost of living, would be about 48% in the United Kingdom and 46% in the United States. This would suggest that at the current rate of exchange the pound is considerably under-valued and this, indeed, is the everyday experience of most visitors from these countries to the United States. This should be a favourable factor in regard to such things as encouraging tourists from the United States and facilitating exports.

It is a fortunate thing for the world that the United States, which possesses such a great capacity for investment abroad, is so favourably disposed towards this task. That is not to say that mistakes have not been made, but it is to be hoped that something

has been learned from these. President Eisenhower in his recent message to Congress suggested that America should increase purchases of raw commodities and basic materials from underdeveloped countries. He envisages that increased trade with these countries would lessen Commonwealth, European and Japanese dependence on direct dollar exports inasmuch as they can earn dollars from the sale of manufactured goods to these countries which have been put in a position to extend their output and shipments of raw products to the U.S.A. This is very much on the lines suggested in our President's paper. Such purchases of raw materials and basic commodities appear to involve an expansion of American investments abroad. The dollar capital sums necessary to develop such backward areas would become available probably to strengthen the reserves of the Sterling Area and other free nations.

Dr. Geary (*Chairman*).—The President's characteristically informative and witty address has been rewarded by an excellent discussion. If time permitted I would have liked to comment on many of the interesting points which were raised in the paper and in the discussion, but I shall have time to deal with only a few.

The chronic dollar shortage of Europe is no new thing. Before the depression in the 1930's, this result of American export pressure and reluctance to accept imports, as indicated by tariff policy, was beginning to assume significant dimensions. You will recall that in Shaw's "Apple Cart ", written, as far as I remember, in the early 'thirties, he envisaged an England of the 1980's being supported by infusions of American dollars. This surely was the prescience of genius. If American import and export policies continue more or less unchanged, the only solution is that a certain proportion of their exports should be unrequited, i.e., they should be presented free to the rest of the world. However undesirable from some points of view, this policy would, at any rate, result in keeping the wheels of industry turning in the United States.

It is interesting to note the emphasis which the President and various contributors to the discussion have placed on the purchasing power parity. It seems to me that Mr. Colbert was very much on the spot when he said that no one in the London money market could tell him on what basis the figure of \$2·80 was determined as the exchange rate for the £ sterling. I thought, however, that he might have given some reasons for his favouring \$3·50: perhaps he would have done so if time permitted. We in the Office recently made some experiments on the purchasing power parity as between this country and the United States at both the wholesale and retail levels. Necessarily our computations extended to a very limited list of commodities which could be regarded as comparable as to quality: the quality difficulty bedevils this kind of calculation. We found that at the wholesale level the appropriate parity was almost exactly \$4, i.e., the exchange rate before devaluation. At the retail level, however, the rate was between \$5 and \$6. These calculations make nonsense of the official rate of \$2·80.

I was much interested in Mr. Bourke's remark, as I understand it, that the \$2·80 was determined not in relation to the general economic situation of the United Kingdom at the time but simply having regard to the British gold-dollar reserve: I think that his inference is correct.

Mr. Colbert, I thought, laid too much blame on the back-room boys. It would be a mistake to under-estimate the influence of Ministers in our democratic system. Surely Mr. Winston Churchill, the Chancellor of the Exchequer, had some direct responsibility for the decision to revalue in 1925. Keynes's influence was very great in 1925 and it is likely that his opinion which, as Mr. Colbert informs us, was against revaluation, was shared by the Treasury officials. This is only surmise; at the same time, the Chancellor's action had a look of politics about it, national prestige and the like. Further, in Mr. Morgenthau's memoirs, he tells a story about President Roosevelt's determination of the exchange rate. It appears that the figure " 7 ", which appeared in the second decimal place, was determined by the President because it was the " lucky number "!